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The Conference Board

Worldbusiness Perspectives No. 79
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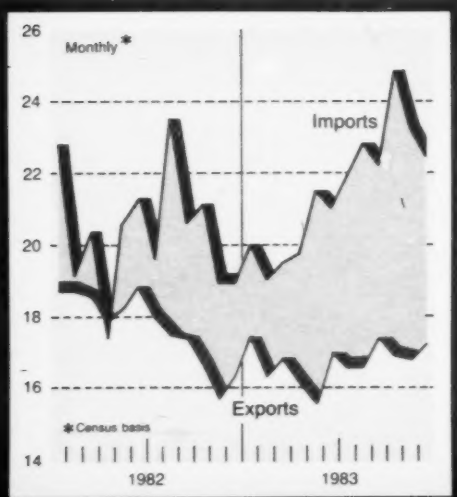
U.S. FOREIGN TRADE IN 1983
Spilling Red Ink

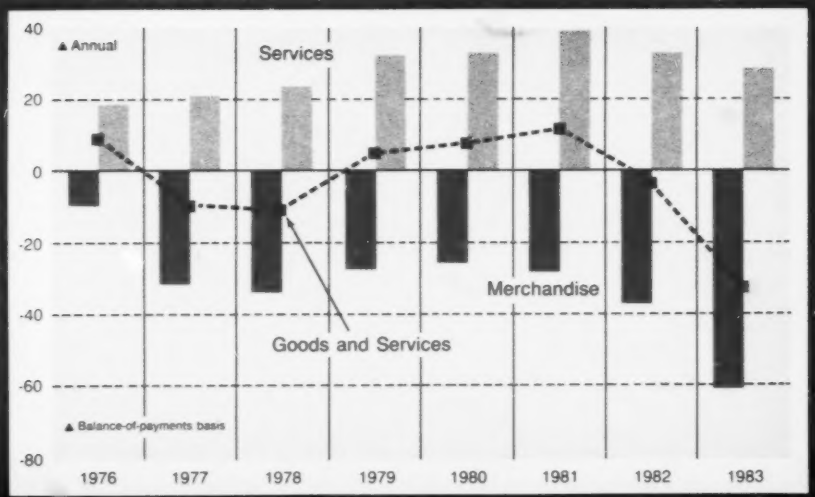
Americans, it used to be said, could afford to conduct their economic affairs without paying much heed to the rest of the world. Over the past few years, however, this attitude has been shattered as declining exports and rising imports led to increasing unemployment in export and import-competing industries—and, in its wake, to mounting pleas for protection.

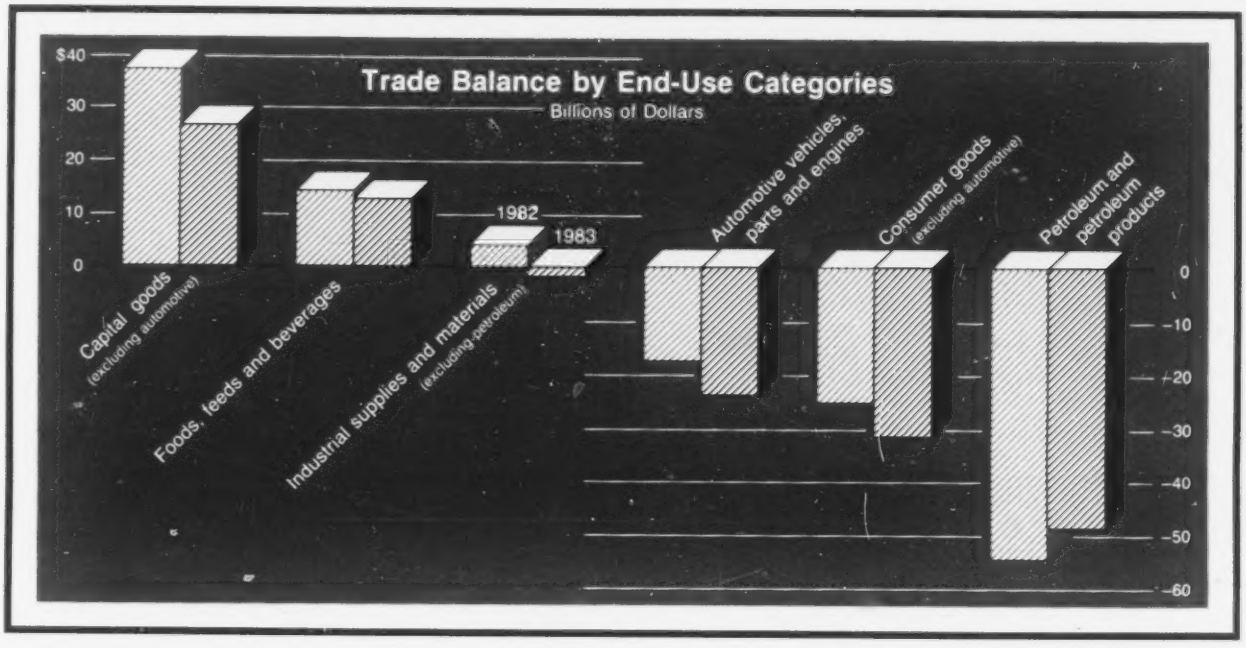
Thus, United States merchandise exports declined from $233.7 billion in 1981 to $200.5 billion last year, a 15 percent drop. (Total world exports declined by only 11 percent over the same period.) United States merchandise imports fell slightly from $261.0 billion in 1981 to $258.0 billion in 1983 (having receded the year between to some $244 billion). As a result, the United States trade deficit grew from $27.3 billion to $57.6 billion over the two-year period. If imports are valued on the so-called c.i.f. basis (see box on page 3), the deficit jumped from $39.7 billion to the mammoth $69.4 billion prominently featured in the press.

The effect of these changes on employment are more difficult to document. A recent study by the Department of Commerce found that in 1982 United States exports generated a total of 4.9 million jobs in all sectors of the economy, and that each $1 billion of exports supported an average of 25,200 jobs. (The corresponding figures for 1980 had been 6.2 million and 28,000, respectively.) The study also found that changes in export-related jobs had a greater-than-proportionate effect on total United States employment. Thus, the 20 percent drop in total export-supported jobs between 1980 and 1982 accounted for 40 percent of the increase in unemployment between the two years.

United States Trade Balance
Billions of Dollars







In the broader context of the national accounts, the decline in net exports of goods and services has had a sharply negative impact on total GNP. In 1982, the fall in net exports contributed 0.9 percent to the decline in real GNP, and last year it shaved 1.2 percent from the real GNP increase. Or, as Federal Reserve Chairman Volcker told the House Banking Committee in February: "It is the exporter, and those competing directly with imports, that have not shared at all proportionately in the recovery."

The most common, and on the surface the most persuasive, explanation for the deteriorating United States trade performance has been the strength or "overvaluation" of the dollar relative to other major currencies. Yet it would be an oversimplification to cite the strong dollar as the sole cause of the worsening of the United States trade account. First, the relationship between changes in exchange rates and changes in trade flows reflects a variety of decisions by both domestic and foreign producers and consumers and cannot be generalized. As one writer on the exchange market has put it: "No hard-and-fast rules can be laid down about these decisions."

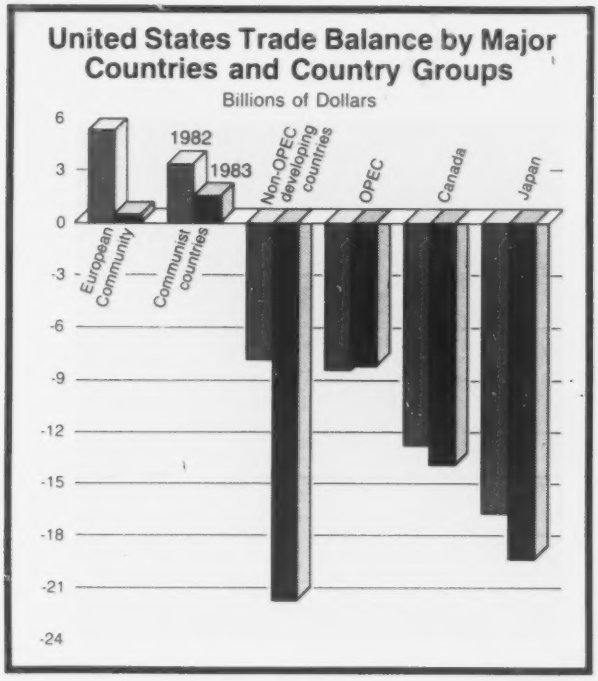
Second, the decline in United States exports in 1982 and 1983 can also be traced to factors other than the strong dollar—the lingering recession (and much slower recovery) abroad, the decline in OPEC revenues, and, above all, the financial squeeze on many heavily indebted developing countries. These strands cannot be sorted out neatly. They contain some intricate cross-connections and feedbacks that do not lend themselves to simple analysis.

Tallying 1983

Both the United States trade and current accounts have deteriorated sharply within the span of a few years. As recently as 1981, the United States current account (the broadest measure of the country's international position) had recorded a $5 billion surplus, as the merchandise trade deficit was more than offset by large services earnings, mainly income on foreign investments. But the trade deficit in the last quarter of 1983 exceeded $90 billion (at an annual rate), while many categories of services weakened at the same time. For instance, the recession abroad and the strength of the dollar both lowered earnings from direct foreign investment, so that the 1983 surplus on services (or "invisibles") shrank to $28 billion. This resulted in a current-account deficit of $41 billion.

These overall figures, however, are believed to be far from accurate. In the past few years, so-called unrecorded transactions have shot up sharply. For the world as a whole, the discrepancy between measured payments deficits and surpluses now amounts to about $100 billion. Much of the reporting problem (or underreporting, as it were) involves investment income, transportation receipts, and various kinds of contractual and professional fees. The United States, the Morgan Guaranty Trust Company pointed out recently, "has a leading position in world services trade, so it is likely that sizable earnings escape the official accounts. The current account deficit may therefore be overstated $20 billion or more."

The most significant element in the poor United States trade performance last year, accounting for virtually all



of the increase in the deficit, was a further decline in the balance on manufactured goods. In this category alone, the deficit widened to $38.2 billion from $10.6 billion in 1982. Since 1980—when a surplus of $12.5 billion was recorded—the adverse shift in trade in manufactures has exceeded $50 billion. Similarly, the 1981 surplus of $25 billion on trade in agricultural products and raw materials last year fell to about $17 billion.

The strength of the dollar has, without doubt, been one element in the growing United States trade deficit and the prime cause for the losses suffered by U.S. exporters in world markets since 1981. But another—and perhaps equally important—reason has been the different timing and pace of the economic recovery in this country and abroad. The 3.3 percent real GNP growth in this country last year was matched more or less in Canada and Japan—but was far in excess of the rate of 0.7 percent recorded by Europe countries. This difference shows up fairly closely in the trade statistics. In 1983, the United States deficit with both Canada and Japan—this country's most important trading partners—did not widen significantly (see table). On the other hand, the United States incurred a trade deficit with most major European countries and its normal surplus with Western Europe as a whole virtually disappeared.

The U.S. trade accounts have also been affected by the debt situation in the developing world, particularly in Latin America. Thus, the 1983 drop in United States sales to Latin America was two-thirds of the total export

Valuing U.S. Imports

Beginning in January, 1974, the Bureau of the Census has published two sets of data for U.S. imports (and hence for the U.S. trade balance). In addition to the so-called f.a.s. or customs value (representing "the transaction value of imports at the foreign port of exportation"), the data also show the so-called c.i.f. value (which includes "all freight, insurance, and other charges . . . incurred in bringing the merchandise from the country of exportation and placing it alongside the carrier at the first port of entry in the United States").

Some caution is indicated when looking at the c.i.f. figures only. To the extent that freight and insurance services connected with U.S. imports are supplied by U.S. firms, they do not represent international transactions, and hence do not generate "outflows" of dollars or additional accumulations of dollars to foreign owners. In other words, measuring imports on a c.i.f. basis is tantamount to implying that the United States provides none of the associated services.

Yet, the monthly trade data that are seized upon so eagerly by the media are on a c.i.f. basis; the corresponding f.a.s. data are released only 48 hours later and generally are not reported by the press. The published trade deficit of the United States with the rest of the world thus tends to be overstated each month; on an annual basis, the difference between the two sets of data becomes considerable (see tabulation). This also means that the often-heard assertion that the growth in the trade deficit will eventually have to weaken the dollar is based on figures that do not entirely represent dollars going to foreigners.

U.S. Trade Balance ($ billion)

	f.a.s.	*c.i.f.*
1974	- 4.5	-12.8
1975	+ 9.1	+ 1.8
1976	- 8.3	-17.3
1977	-26.5	-36.4
1978	-28.5	-39.6
1979	-24.6	-37.2
1980	-24.2	-36.4
1981	-27.3	-39.7
1982	-31.8	-42.7
1983	-57.6	-69.4

Ten Leading U.S. Trading Partners, 1983

Exports		Imports	
Total	$200.5 bill.	Total	$258.0 bill.
(1) Canada	17.3%	( ) Canada	20.2%
(2) Japan	9.9	(2) Japan	16.0
(3) United Kingdom	4.8	(3) Mexico	6.5
(4) Mexico	4.1	(4) Germany	4.9
(5) Germany	3.9	(5) United Kingdom	4.8
(6) Saudi Arabia	3.9	(6) Taiwan	4.3
(7) Netherlands	3.5	(7) South Korea	2.8
(8) France	2.7	(8) Hong Kong	2.5
(9) South Korea	2.7	(9) France	2.3
(10) Belgium	2.3	(10) Italy	2.1
	54.8%		66.4%

decline of $11.7 billion. Moreover, Mexico, which is this country's fourth largest market and accounts for nearly half of our exports to Latin America, was among the first of the Latin American countries to curtail its imports because of financial difficulties. The full impact of the economic contractions in Brazil and Venezuela made itself felt only last year. The decline in exports to Latin America since 1981 has affected every major category of United States exports. It has been particularly pronounced in several major industries—such as machinery, transportation equipment, and iron and steel products—that were already hard-hit by the 1981-1982 recession.

More Red Ink in 1984

In attempting to project the course of U.S. foreign trade in 1984, a number of commentators have pointed to what they consider the inevitable weakening of the dollar this year and thus to a turnaround, or at least an improvement, in the U.S. trade accounts. But as the preceding discussion has shown, the decline in United States exports over the past two years or so is only partly related to the strength of the dollar. Factors other than the dollar that have affected U.S. exports adversely are likely to continue exerting their influence, at least for the remainder of 1984. Early estimates speak of a trade deficit of perhaps close to $100 billion.

First and foremost, the cyclical divergence between the United States and Western Europe is likely to persist. As the Conference Board's *International Economic Scoreboard* noted at the beginning of the year: "In Europe... the recovery is developing more gradually than in North America and Japan. The combined leading index for France, West Germany, Italy and the United Kingdom was rising at an annual rate of 6 percent in October, while the leading index covering the United States, Canada and Japan was climbing at a 15 percent rate."

Second, while the debt situation of the developing countries, most importantly those in Latin America, currently is under control, it is not going to be resolved in a period as short as a year. The borrowing requirements of the LDC's will remain quite high for some time to come, necessitating substantial financial flows from banks and international financial institutions as well as continued retrenchment at home. Only strong and continued growth in the industrial world will give these countries the chance to resolve their debt problems satisfactorily. Nor does it appear likely that oil prices will shoot up once more to levels that would permit the OPEC countries to become substantial buyers of United States products.

As to the dollar itself, most analysts agreed early this year that any weakening in 1984 would be slight—amounting to no more than between 10 and 15 percent on a trade-weighted basis (i.e., against a basket of 15 major currencies). But it needs to be stressed that over one-third of U.S. exports go to four markets—Canada, Japan, Mexico and the United Kingdom. The currencies of those four countries are unlikely to strengthen against the dollar by as much as 10 to 15 percent.

That is not to say, of course, that in the longer run a marked decline in the dollar cannot improve United States international competitiveness again. Thus, during 1978-1980, when the dollar fell sharply, United States exports were able to grow at double the rate of world trade generally, and actually recaptured the share of world exports of manufactures that they had lost earlier in that decade.

At the Conference Board's annual Financial Conference in February, one speaker asked: "Can any company export today?" He went on: "The answer for most United States firms is pretty clear...only with difficulty. Yet, final results for 1983 also confirm that many are still exporting, even as others suffer collapse in orders and shipments." He then outlined other elements of the "marketing mix" that he saw as becoming increasingly important in the face of a strong dollar: "A new or differentiated product; a more accommodative distribution system; or a better-targeted promotion. But each possible offset involves an upgrading of marketing budgets and more financial risk." It is clear, he concluded, "that few U.S. exporters can hope for any repeat of success stories of the 1970's variety without extraordinarily hard work."

John Hein

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The Conference Board

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FOREIGN CAPITAL EXPENDITURES BY U.S. COMPANIES
Reaching for a New Peak

There is a clear-cut slow in the attitude of many United States manufacturers toward expending money for plant and equipment in foreign countries in 1984. At the same time, even more are proceeding with caution.

According to the latest survey (April 1984), nearly 39 percent of the respondents plan to spend more in 1984 than in 1983. This was well above the 34 percent who replied in the same way to the previous survey (October, 1983). It is nearly double the 20 percent who had plans for expanded plant and equipment expenditures when queried a year ago (in April, 1983). (At that time, the comparison was of expenditures in 1983 with those for 1982.)

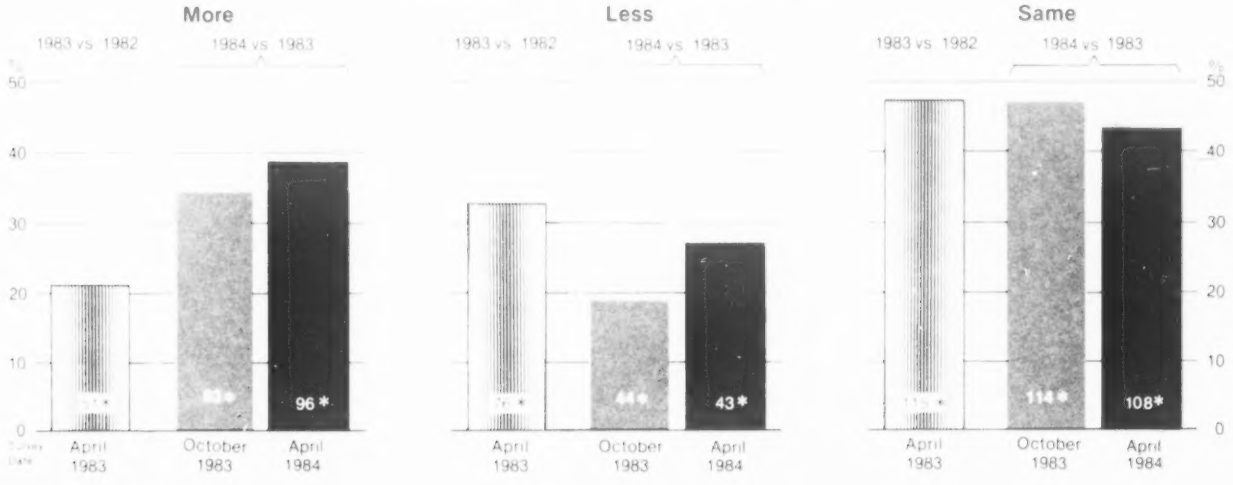
At present, still nearly 44 percent of the companies plan to spend about the same in 1984 as in 1983. This proportion is moderately down from the prior survey, when 47 percent of the respondents indicated that they planned to hold to the level of 1983.

The survey conducted by The Conference Board is aimed only at comparing the direction of current investment intentions with past levels on a company-by-company basis, without seeking dollar magnitudes. In the December, 1983 survey of the Department of Commerce (the latest aimed at estimating capital spending in dollars), manufacturers (including petroleum companies) stated that they expected to spend a little more than $35 billion in 1984, a 13 percent increase over 1983. Even if this substantial increase is realized, such expenditures will still be slightly below the record 1982 level.

J. Frank Gaston

Manufacturers' Plans for Plant and Equipment Expenditures Outside the United States

Number and Percent of Companies Planning to Spend



*Number of companies

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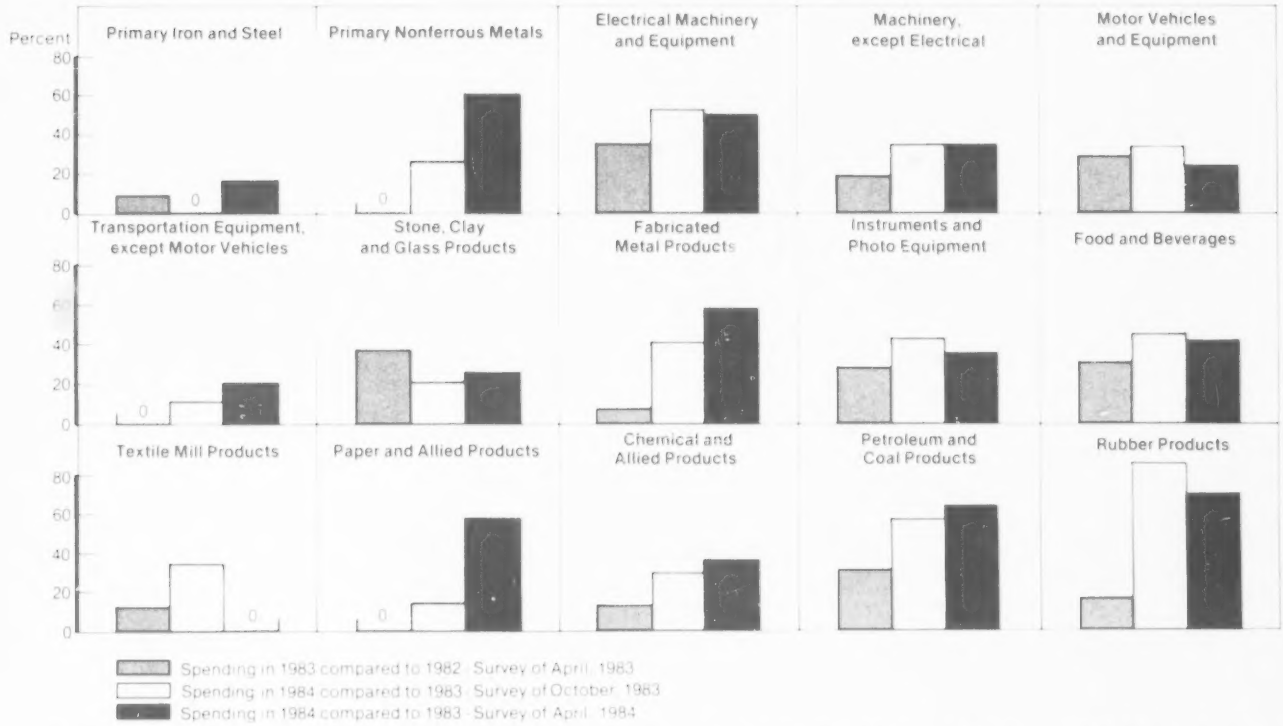
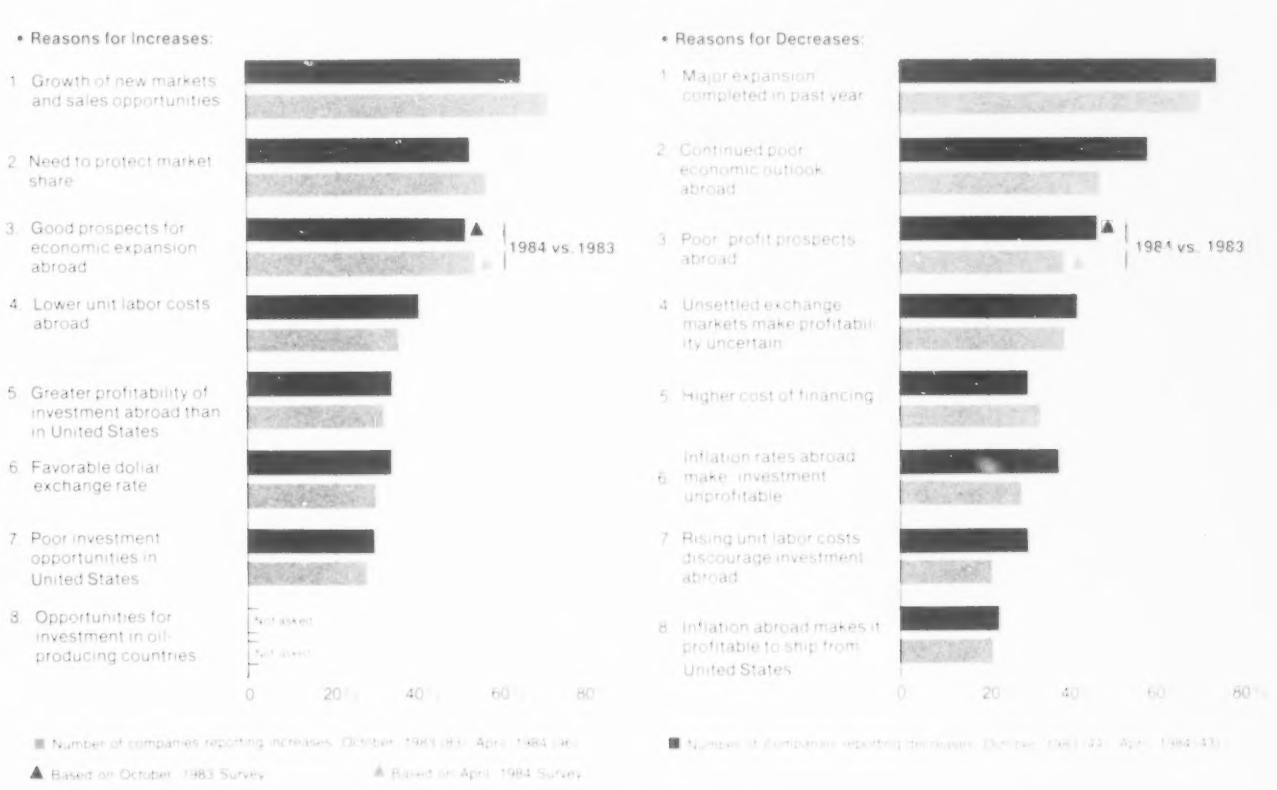
Spending Plans for Plant and Equipment Outside the United States by Industry

Percent of Companies Planning to Spend More


Percent
Primary Iron and Steel
Primary Nonferrous Metals
Electrical Machinery and Equipment
Machinery, except Electrical
Motor Vehicles and Equipment
Transportation Equipment, except Motor Vehicles
Stone, Clay and Glass Products
Fabricated Metal Products
Instruments and Photo Equipment
Food and Beverages
Textile Mill Products
Paper and Allied Products
Chemical and Allied Products
Petroleum and Coal Products
Rubber Products
Spending in 1983 compared to 1982 : Survey of April, 1983
Spending in 1984 compared to 1983 : Survey of October, 1983
Spending in 1984 compared to 1983 : Survey of April, 1984

Reasons for Plant and Equipment Expenditures Outside the United States—All Manufacturing


Percent of Companies Reporting
• Reasons for Increases:
1. Growth of new markets and sales opportunities
2. Need to protect market share
3. Good prospects for economic expansion abroad
4. Lower unit labor costs abroad
5. Greater profitability of investment abroad than in United States
6. Favorable dollar exchange rate
7. Poor investment opportunities in United States
8. Opportunities for investment in oil-producing countries
1984 vs. 1983
Not asked
Not asked
0
20
40
60
80
• Reasons for Decreases:
1. Major expansion completed in past year
2. Continued poor economic outlook abroad
3. Poor profit prospects abroad
4. Unsettled exchange markets make profitability uncertain
5. Higher cost of financing
6. Inflation rates abroad make investment unprofitable
7. Rising unit labor costs discourage investment abroad
8. Inflation abroad makes it profitable to ship from United States
1984 vs. 1983
0
20
40
60
80
Number of companies reporting increases: October, 1983 (81); April, 1984 (96)
Based on October, 1983 Survey
Based on April, 1984 Survey
Number of companies reporting decreases: October, 1983 (33); April, 1984 (43)

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The Conference Board

Worldbusiness Perspective No. 81
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PRODUCTIVITY IN MANUFACTURING
A New Country Alignment?

Productivity (output per employee hour) in United States manufacturing leaped sharply upward in the year ending 1983, the most recent one for which data are available. The rise was so sharp as to exceed that of any year back to 1950 except for 1962-1963 when a rise of more than 7% was recorded.

Early indications are that this surge in productivity continues into 1984, and perhaps at nearly the same high rate. A crucial factor will be the pace at which manufacturing output continues to expand.

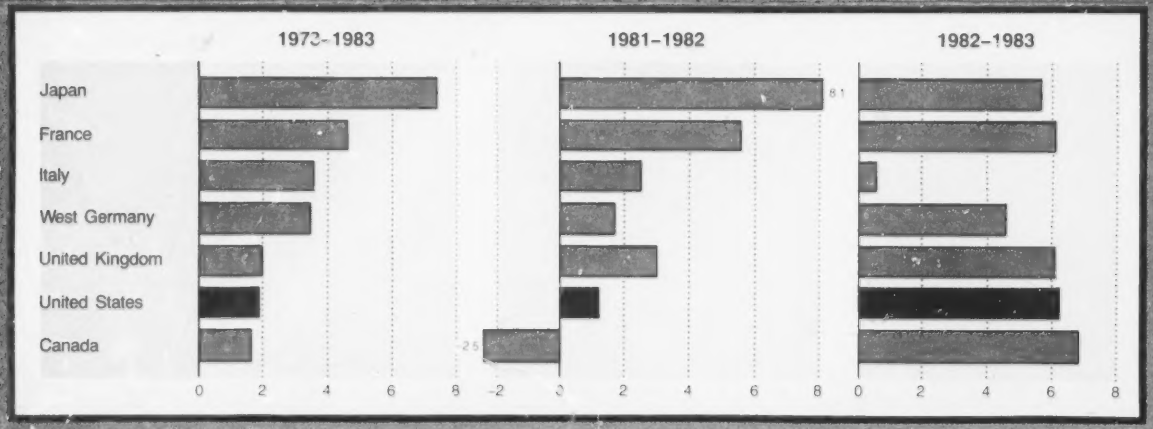
As a result of the sharp jump in United States productivity, it held second place in the ranking of the seven major manufacturing countries in the world. By contrast, it was next to last in the year before and in the ten year interval, 1973-83.

Canada also showed a sharp gain in 1983. As a matter of fact, its 6.8% increase made it first in 1983, a sharp turnaround from the 2.5% drop of the year before.

The jump in United States productivity has been accompanied by a similar experience in nearly all of the principal industrial countries of the world (see chart below). All of the countries, except Italy, show an annual rise of more than 4% in manufacturing productivity, a sharp improvement over their performance last year as well as the average of the past ten years. Italy showed a sharp decline in 1983 from the year before so that there was only a .6% rise recorded.

Japan too exhibited exceptional behavior. It, like Italy, showed a drop in productivity growth in 1983, but even so, productivity as still advancing at a high rate. The 1983 increase in Japan in Japan of 5.7% placed it in fifth position among the seven countries. By contrast with its record of the past ten years, however, the 1983 performance in this country is something of a comedown.

Manufacturing Productivity Compared
Average Annual Rate of Change per Employee Hour



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What is one to make of this sharp break in recent historical experience? Is there any suggestion in these data that the United States and Canada will change their accustomed position of being at the bottom of the international productivity race? Given the factors that have brought about this abrupt change in the rate of productivity growth in individual countries, what implications are there for the future?

Part of the answer to the question of how much of a break does the 1983 record make with past experience is presented in the first chart. For every country but Italy and Japan, the 1983 experience is so much better than that of 1973-83.

If the historical record is examined for a more remote period, however, the 1983 performance appears to be less spectacular. In the 1960-73 period, France, Germany showed a sustained productivity growth that exceeded the 1983 experience. So did Italy and by a wide margin since 1983 growth was down to nearly one-half of a percentage point. In Japan, productivity growth was proceeding at a 10.7% annual rate, well above that of any other country and well above its still-high 1983 performance.

Output per Employee Hour,
A Long Look
Average Annual Rates of Change

	1960-73	*1973-83*
United States	3.0	1.9
Canada	4.5	1.7
Japan	10.7	7.4
France	6.7	4.6
Germany	5.7	3.5
Italy	6.9	3.6
United Kingdom	4.4	2.0

Only in Canada, the United Kingdom and the United States was the 1960-73 record poorer than the one in 1983. Even so, productivity was moving upward at respectable rates for all three. Respectable in these cases meaning that the rates were above those prevailing in the decade 1973-83.

The 1983 surge then is at variance with the recent past. It does not, however, represent a break with longer historical experience. There is precedence for the welcome productivity jump that occurred.

Productivity changes as recorded in the usual statistics are notoriously subject in the short run to fluctuations in economic activity. There is no surprise in this since the customary procedure used to calculate productivity is to compare the change over time in an indicator of output with an indicator of input. A change in either series will affect the calculated measure of productivity. Generally, the input used is total employment or total workhours that has been employed to produce the output. These component statistical series do not always move in step and, consequently, may bring about changes in the productivity indicator. These changes are not necessarily reflective of any alteration in underlying technique of manufacturing or efficiency in the use of resources.

As an extention of this feature of most productivity measures, one should also guard against interpreting them as indicating neat cause and effect. Expressing productivity as output per employee hour is largely a matter of convenience and does not mean that the identified input is solely responsible for the identified output.

The production process is a complicated one in which technology, capital investment, capacity utilization, energy use, managerial skills all play a part. To attribute to each factor a quantitative importance in bringing about changes in output is extremely difficult, although efforts have been made. The statistical difficulties are nearly impossible to overcome. As a result of the availability of data on employment and hours, the usual practice is to use the output-employee hour ratio as an indicator of productivity or of productivity changes.

The seven countries fall into two distinct groups upon examination of the immediate factors bringing about the 1983 changes. On the one hand are the United States, Canada and Japan, linked because their 1983 productivity growth is due largely to significant upswings in manufacturing output, each showing a rise of more than 6%. Among these countries, changes in total hours were relatively slight and, therefore, played only a small part in the movement in the statistical indicators of productivity. The increase in productivity was the result of sharp rises in output with only minor changes in the input of employee hours.

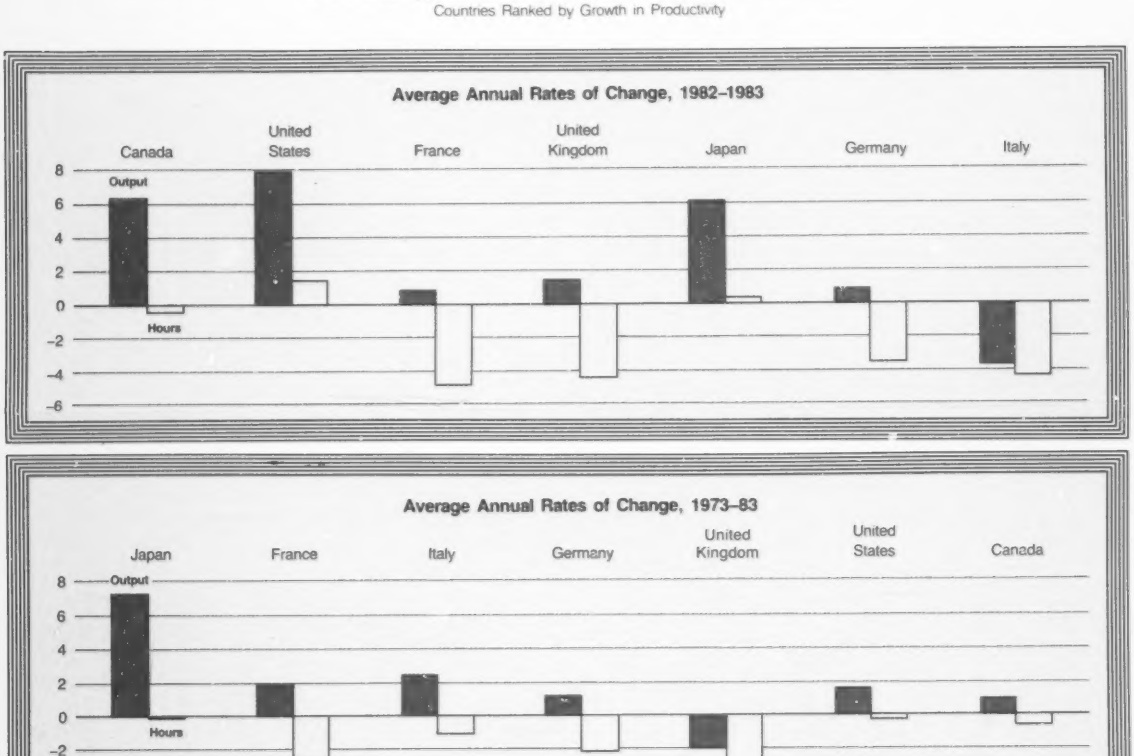
By contrast, three countries—France, Germany and the United Kingdom—showing increases in 1983 productivity, two of them substantially, the change in output has been relatively modest. In Italy there was an actual decline in output, while productivity increased to a minor extent.

What accounted then for their relatively bright record in productivity? The immediate answer as recorded in the statistics for these countries was the sharp decline in employee hours. In all four countries, there was a substantial drop in total hours ranging from nearly 5% in the case of France to 3.5% in the case of Germany. Moreover, the 1983 drop in hours continued the decline experienced in the two previous years. During these same three years, 1981-83, employment dropped sharply as well.

The two groups are differentiated, therefore, primarily by the timing of their economic expansion. In the first group of countries, economic expansion was already taking hold, in the United States quite vigorously. In the second group of countries, no such expansion had yet taken hold. As a matter of fact, these were still in the contracting phase as evidenced by the fact that they were continu-

Accounting for Productivity Growth in Manufacturing

Countries Ranked by Growth in Productivity



ing to reduce hours in 1983 at about the same pace as in the immediate past while output was advancing modestly if at all.

If the principal industrial companies in Europe were able to maintain productivity increases by reducing hours in the face of little or no growth in output, what would happen if their manufacturing industries were to come alive in 1984. The answer is obvious enough: productivity would expand. To what extent is that likely to happen?

There is already some partial indication in the regular statistical series that manufacturing output is expanding in 1984, at a somewhat faster rate than in 1983. Second, there appears to be some evidence from surveys of businessmen that future business prospects are looking up. This is far from conclusive since the indications are weak and since these surveys rest upon judgments about the future, they are easily subject to change in the light of developments.

Third, since businessmen report that capacity is far from being fully utilized a growth in demand could largely be met from existing facilities. This possibility provides a setting for a statistical rise in productivity.

It appears that the 1983 experience may be repeated in 1984. Certainly for the United States, prospects for 1984 look very favorable since recorded manufacturing productivity in the first half advanced at about the same pace as in 1983. But what about 1985 and beyond? Will it take its accustomed position near the bottom of the pack?

Japan, normally far out in front, has faltered lately. Does this represent a new fundamental position in a new economic environment or only a temporary setback? Once manufacturing picks up will Japan resume its leadership position?

All the factors that impinge upon the long-term future course of productivity cannot be examined here. There is virtually no end to the factors that have been identified as having some force in increasing productivity. Technological advances, research and development expenditures, business capital investment, economies of

scale, changing composition and quality of the workforce, substitution of one production factor for another, e.g., energy for human power, investments in human capital, employment of resources in industries with higher productivity, managerial capability and creativity, change in product design, extent of the regulation of business enterprise for other purposes, e.g., pollution control, financial incentives, tax deterrents and other actions by government that wilt or foster business growth.

All of these factors can interact, of course, so that it is no easy task to attempt to assign a quantitative role to any of them. All of these factors have been examined, but so far not with clear-cut success.

In attempting to peer into the future, it is vital to examine the long-term record of productivity changes among these seven countries. As already noted, all of them exhibit a tendency for short-term changes in productivity to react sharply to changes in output and in input measured in hours. Despite these sharp changes from year to year, over the long term, these countries have not changed their relative position to any major extent.

The countries are ranked by the rate of productivity growth in the period 1973-83 in about the same order as they were in 1960-73. Going back even further, the ranking in the decade 1950-60 does not differ to any significant extent from the more recent periods.

Ranking in Average Annual Rate of Growth in Output Per Employee Hour in Manufacturing

	1973-83	*1960-73*	*1950-60*
Japan	1	1	1
France	2	3	4
Italy	3	2	3
Germany	4	4	2
United Kingdom	5	6	6
United States	6	7	7
Canada	7	5	5

Ranking the countries of productivity growth over substantial periods of time as in the table above serves to neutralize the impact of the business cycle to a substantial extent. Short-term changes in output and in input of hours, which can affect the position of countries as evidenced by the 1983 experience, are ironed out by extending the period of observation. By implication then, the other factors deemed important to productivity are emphasized by this ranking.

The relative stability in ranking suggests that some major change in the economy of individual countries must occur (not concurrently taking place in the others) before it can change its position. The implication is that of the many factors underlying productivity changes, none has so changed as to lift one country to the top that previously was at the bottom. Similarly, none has fallen sharply from its earlier high position.

Of all factors cited above, the one that can be regarded as of prime importance in assessing the future course of productivity is capital investment, particularly in business capital. Not only is capital investment by business an important factor by itself, it can also be regarded as an important proxy or embodiment of other factors cited above. The impact of research and development expenditures, for example, is often through new capital expenditures.

In this respect, there appears to be no significant change in the record of the countries that would have some long-term implications. The United States has regularly been ranked at the bottom with respect to the proportion of gross domestic product devoted to capital investment among the seven industrial countries. Japan has regularly ranked at the top with respect to this factor.

There appears to be nothing in the offing that would make for a quick change of such a ranking. The output of investment goods in the United States has shown a sharp rise early in 1984, about in step with industrial production. The percentage of output, therefore, devoted to capital investment cannot have changed materially.

In Japan, about the same behavior is exhibited, although both output of investment goods and overall industrial production has increased at a somewhat slower rate than in the United States. The differential change has been slight in the case of both countries. In the light of the fact that Japan traditionally has had a ratio of gross domestic investment to gross domestic production nearly twice that of the United States, these small differentials for such a short period cannot have any influence in changing the respective rankings.

Canada and the principal industrial countries in Europe have also historically devoted a higher percentage of their output to gross investment than the United States. So far no evidence points to a change in this position. It is reasonable, therefore, to interpret the recent high growth rate of productivity in the United States as a cyclical phenomenon and not the beginning of a realignment of its ranking among the major industrial countries. The continued current expansion of manufacturing output here will serve eventually to press against available resources resulting in a slowup in productivity growth. Meanwhile, there are grounds for expecting productivity, as customarily measured, to increase in the other industrial countries.

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